IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1977

No. 77-1253

LESLIE W. NIMMO, et al.,

Petitioners,

vs.

CHARLES S. GRAINGER, et al., on behalf of themselves and others,

Respondents.

REPLY BRIEF OF PETITIONERS FOR CERTIORARI

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Your petitioners (defendants below), Leslie W. Nimmo and Nimmo & Associates, Inc. (an Illinois corporation dissolved prior to this litigation), respectfully submit this brief in reply to matters raised by respondents (plaintiffs below) in their recently filed brief in opposition to the Petition for Certiorari in this cause. That petition seeks review of the decision of the Fifth Circuit in this $3 million class action subjecting life insurance policies to 10b-5 litigation under the Federal Securities Laws.

Your petitioners submit that an analysis of the opinions—initial and on rehearing—of the panel of the Fifth Circuit clearly shows that those opinions have created new securities law affecting life insurance policies that is appropriate for review by this Court. In addition, that new law cannot be confined to the particular provisions of the life insurance policy here involved that was issued by Great States Life Insurance Company ("Great States") since, as shown by Exhibit A to the Petition for Certiorari, the Great States participating provision that was

the genesis of this litigation is a standard provision comparable to those used in almost 60% of the life insurance policies now in effect in the United States.

I. Because of the "Totality of Circumstances" Test of the Fifth Circuit, this Case is in a Posture Appropriate for Review by the Supreme Court.

The panel of the Fifth Circuit has now held (A-15) that in the sale of participating endowment insurance policies, "the totality of the circumstances surrounding their sale, including any oral representations made," can cause the policies to become "securities" under the Federal Securities Laws. This "totality of circumstances" test, thus, creates a potential security out of any life insurance policy (or, at least, out of all but term insurance policies). While it is true, as urged by plaintiffs, that the Fifth Circuit remanded this case for further proceedings, the importance of the decision below and its applicability to so many insurance policies now in effect makes this case appropriate for review on certiorari.[1]

(A) National Importance of Issue Decided by Fifth Circuit.

Plaintiffs cite the well-known text on *Supreme Court Practice* by Stern and Gressman for the proposition that the Supreme Court will not usually grant certiorari to review a non-final judgment. However, plaintiffs fail to continue the discussion by those authors where they state, "Where there is some important and clear-cut issue of law that is fundamental to the further conduct of the case and that would otherwise qualify as a basis for certiorari, the case may be reviewed," citing several cases including *Land v. Dollar*, 330 U.S. 731, 734, n. 2 (1947), and *Larson v. Domestic & Foreign Commerce Corp.*, 337 U.S. 682, 685, n. 3 (1949). In those last two cases, this Court reviewed de-

[1]The broad scope of the decision is indicated by the fact that applicability of this "totality of circumstances" test was discussed in a seminar on the securities laws held in January of this year where members of the SEC and eminent securities practitioners were among the speakers. See BNA Securities Regulation and Law Report, No. 438, page A-26 (Feb. 1, 1978).

cisions raising important jurisdictional questions when the court of appeals had reversed the granting of a motion to dismiss (as contrasted with summary judgment here) and had ordered the case remanded for trial. Stern and Gressman, *Supreme Court Practice* (4th Ed., 1969), Sec. 4.19. Further, in addition to the securities cases cited at pg. 22 of the petition, this Court has recently granted certiorari in *Daniel* where the case was appealed from denial of motions to dismiss.[2]

It is obvious that lengthy proceedings, consuming time of the lower court and expense of the judicial process, will surely ensue if this case is remanded for further consideration under the above "totality of circumstances" test. It, thus, would be most counter-productive in judicial administration for this case now to be remanded, tried and then appealed in order for it finally to be determined whether a participating or endowment life insurance policy can become a security by reason of its method of sale. Consequently, the case is in a posture necessitating that that question, decided by the panel of the Fifth Circuit, be reviewed now.

That the decision by the panel of the Fifth Circuit has broad ramifications that can affect many insurance policies is clearly shown merely by reference to the factors cited as examples at the end of its short opinion on denial of rehearing. The suggestion that a high premium/death benefit ratio can cause an insurance policy to become a security obviously affects all endowment policies and especially term endowments (i.e. those where the premiums are paid for a short term rather than, for example, until age 65). In addition, any policy that carries coupons would also be subject to examination in a court proceeding. Lastly, any policy where the word "investment" was mentioned in its sales literature (even though all policies except term, of necessity, must have an investment element) and any instance where an insurance company salesman emphasized the investment element of that policy would obviously become potential securities. The doors of the federal courts are, thus,

[2]*Daniel v. International Brotherhood of Teamsters, etc.*, 561 F.2d 1223 (7th Cir. 1977), cert. granted 46 U.S.L.W. 3512 (U.S., Feb. 21, 1978).

opened to 10b-5 litigation over all such policy elements. Petitioners, therefore, submit that it is clear that this issue is of national importance and is now appropriate for decision by this Court.

(B) Procedural Status is Appropriate For Review.

At many instances in their opposition brief, plaintiffs urge that the case be remanded because it was decided by the District Court on motions to dismiss rather than motions for summary judgment. This is, however, incorrect and, knowing that this issue had become involved in the case on the appellate level, petitioners thought they had given ample references to correct this misapprehension in their initial petition (pg. 21).

This case was argued on appeal at the same time as another securities case involving life insurance policies where the same attorneys represented the plaintiffs—*Hilgeman v. National Insurance Company of America,* 547 F.2d 289 (5th Cir. 1977), which, although not a companion case in the lower courts, was treated as a companion case by the Fifth Circuit. The procedure in *Hilgeman* was, however, entirely different from that in *Grainger.* In *Hilgeman* there had been an order blocking discovery; and the case, which involved a number of complicated procedural questions, was appealed from granting of motions to dismiss under Rule 12(b). However, the situation was different in *Grainger* where the complicated procedural questions did not exist and where the District Court decided the case on summary judgment under Rule 56.

This is made clear by the court's order of June 20, 1977 (A-17), in which the District Court elected "to treat the motion to dismiss filed in behalf of each defendant as a motion for summary judgment" and to allow the parties to submit any affidavits or other documentary evidence which they may deem relevant to determination of whether the insurance contracts involved constitute "securities". There had been no order blocking discovery as erroneously indicated in the Fifth Circuit's panel decision at 547 F.2d 305 (headnote 1) (A-8); and the District Court had before it extensive depositions, most of

which were taken by plaintiffs. Further, the District Court in its final opinion did clearly state that the nature of the case "warrants the consideration of more evidence than is usually appropriate to motions to dismiss" (A-23), thereby showing that it considered evidence extrinsic to the face of the insurance policies in determining whether they were securities. In fact, the District Court clearly showed such consideration where it concluded after reviewing plaintiffs' evidence, "At most, plaintiffs indicate that the salesman treated the 'V.I.P.' insurance contract as if it were a 'security' ", thereby showing that the court considered all the evidence that plaintiffs submitted through depositions and by affidavits in reaching its decision. Notwithstanding the above status of the record, plaintiffs state in their opposition brief, at page 3, "Thus, the District Court's order of June 5, 1975 (its final order) appears to have been entered pursuant to Rule 12(b), rather than Rule 56, as defendants' claim." This is simply not true. Plaintiffs should know it is not true because they submitted affidavits in response to the court's previous order directing that the case be decided on summary judgment.

It is obvious that the Fifth Circuit got the procedural status of the two cases confused because it referred to there being an order blocking discovery in *Grainger* when there was no such order in *Grainger* but there was one in *Hilgeman*. However, in order to preserve the "totality of circumstances" test, plaintiffs are now urging a perpetuation of that error. If the plaintiffs had any further evidence, in addition to the lengthy depositions and the affidavits they submitted, they should have brought it forward before the lower court and not now later by urging that the case should be remanded.

As a result of the foregoing, it will be seen that any application of the parol evidence rule referred to by plaintiffs did not actually occur in *Grainger* and, if it were applicable anywhere, it would be applicable to *Hilgeman*, which is not now before this Court. Thus, the discussion in Part II of plaintiffs' opposition brief is actually inapplicable to the procedural status or facts involved in *Grainger*. Petitioners, therefore, strongly

urge that this case is in a proper procedural status to be brought before this Court for determination. To hold otherwise would clearly not be in the efficient administration of the judicial process.

(C) Evidentiary Status is Appropriate for Review.

Plaintiffs claim, at page 16 of their opposition brief, that the defendants cite "various books of a technical nature" and that, therefore, the case should be remanded. We submit that this clearly is a mistake in application of rules of evidence and the citation of authorities. The references to which plaintiffs refer are two. The first is to Huebner & Black, *Life Insurance* (8th Ed. 1972), for a sample standard form of life insurance participating provision. This provision is the genesis of this litigation where plaintiffs have contended that the life insurance exemption or exclusion from the Federal Securities Laws should be confined to policies of pure risk insurance (i.e. term) and have tried to equate the Great States participation provision with the special fund used in *United Benefit.*[3] In the lower court, the Great States participating provision was compared with actual provisions of other contracts in wide use in Alabama. On rehearing, petitioners referred to a standard text so that the court would have a textbook for ready reference rather than presenting provisions of specific contracts; but the provisions are all substantially similar and reflect the nature of standard participating clauses. We submit, therefore, that there is nothing to be gained by remanding this case for consideration of whether the Great States participating provision is like the standard clauses of other specific policies or like the standard clause contained in Huebner & Black (which clearly appears from the comparison set forth in Exhibit A to the petition).

The other insurance text to which plaintiffs refer is *Flitcraft Compend* (1962), cited to show a comparison between the premiums charged by leading life insurance companies in the United States for similar policies issued in the same year (1962)

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[3]*S.E.C. v. United Benefit Life Insurance Co.*, 387 U.S. 202 (1967).

as the Great States policy being attacked here. In actual effect, the pricing of a life insurance policy should probably not affect whether it is a "security" or not, in which case this attack by plaintiffs would be entirely irrevelant. However, in the event it might be considered relevant by the court, petitioners were merely pointing out that the premium/death benefit ratio for the Great States policy was not out of line and, in fact, was comparable to those of major life insurance companies. This issue was not raised in the lower court or by plaintiffs on appeal but only by the Fifth Circuit in its initial panel decision. Thus, it was necessary, on rehearing, to present the information through reference to a recognized work containing data respecting life insurance policies. This we submit is entirely proper since *Flitcraft* is a standard copyrighted text, published annually and independently from any insurance company, that sets forth quotations for various life insurance policies issued by the leading life companies doing business in the United States. Further, as such, the courts can take judicial notice of it.[4] In fact, *Flitcraft Compend,* which should be found in any library containing insurance publications, could be considered similar to Best's Insurance Reports, which are cited by plaintiffs at least twice in their own brief.

Petitioners submit, therefore, that the evidentiary status of this case also shows that it is in a posture to be decided by this Court. This is not having an appellate court try a case de novo as contended by plaintiffs; it is merely permitting the court to avail itself of appropriate information available in recognized works of reference.

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[4]See *Iberian Tankers Co. v. Gates Construction Corp.,* 388 F.Supp. 1190 (S.D.N.Y. 1975) (reference to publication of investment banking firm, "Salomon Bros. Statistical Yields", for judicial notice of interest rate on 3-month U. S. Government securities); *Baumel v. Rosen,* 283 F.Supp. 128 at fn 8 (D Md. 1968), aff'd in part, rev'd in part on other grounds 412 F.2d 571 (4th Cir. 1969), cert. den. 396 U.S. 1037 (1970) (reference to *Wall Street Journal* for judicial notice of trading prices of a particular stock). "In accord with the usual view, judicial notice may be taken at any stage of the proceedings, whether in the trial court or on appeal." Comment to Rule 201 (f), Federal Rules of Evidence.

II. The Great States Policy is Not a Non-standard Policy that would Preclude Application of the Fifth Circuit's Decision to Many Other Insurance Policies.

Plaintiffs contend that the Great States life insurance policy is a "specialty" policy, mentioning at numerous points in their opposition brief that it is not like other policies and, therefore, not meriting this Court's review. It seems obvious, however, from a comparison of the participating provisions set forth in Exhibit A to the petition that the Great States participating provision is a standard one. Plaintiffs, thus, seek to emphasize two factors which they claim make the policy a specialty. The first is distribution with the policies sold in Alabama of a copy of the Illinois law requiring that a certain percentage of profits from a company's participating business inure to the benefit of the participating policyholders. See the provision set forth at A-3,4 and discussed at footnote 3 of the petition. We submit that it is most difficult to ascertain how communication to an insured of a specific provision of the laws governing his policy would serve to make that policy a so-called "specialty" policy.

The other factor relied on by plaintiffs—and done so extensively in their opposition brief—is the fact that the Great States policy contained coupons, which were of fixed amounts and could be used for various options including the reduction of premiums or purchase of additional insurance, thereby showing their clear relation to the insurance policy to which they were attached. This matter is discussed in footnote 7 on pages 14-15 of the petition where it is noted in Appleman, *Insurance Law and Practice,* that, although coupon policies are not widely used, "they are a standard form of insurance." Coupling that with the fixed dollar amounts of the coupons, it would seem that their presence could hardly cause an insurance policy to become a "security". Thus, they are irrevelant to the basic issue here, which is whether an insurance policy can become a security.[5]

[5]Plaintiffs cite Departmental Regulation No. 17 of the Alabama Insurance Department on several occasions for the proposition that coupon policies are illegal. Actually it is Departmental Regulation No. 47, a copy of Rule 2 of which pertains to coupon policies and is set forth as an ex-

Your petitioners submit that plaintiffs—and, in fact, the panel of the Fifth Circuit—are clouding the true issue involved in this case by trying to focus on such matters as attachment of coupons of fixed value to a policy or on distribution with it of the participating provision of Illinois law, when it is obvious the true issue is: Can method of sale change a life insurance policy with a standard participating provision into a "security", i.e. can method of sale create a "security" out of something that Congress determined, in enacting the Federal Securities Laws, is not a "security"?

While plaintiffs make the general allegation that petitioners have misstated the facts, no specific examples are given. However, in their statement of facts, which presumably is intended to supplement that contained in the petition, they quote substantially from a summary contained in the SEC's amicus curiae brief submitted to the Fifth Circuit on the rehearing where the SEC, in general, supported plaintiffs' position by an advocate-style brief.[6] The SEC was obviously removed from the trial proceedings in the case below and, we submit, took certain liberties in interpretation of the District Court's decision. These inaccuracies are, thus, now repeated in the opposition brief before this Court. The cited references do not necessarily support the propositions for which they are cited; and an examination of those references shows that they do not actually alter the summary of the facts in the petition. However, we do not feel it is the province of a petition for certiorari to burden this

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tension of the appendix (A-55) and attached hereto since it is not set forth in plaintiffs' opposition brief. This regulation was adopted in 1967 — five years after the sale of the Great States policies here in issue — and even then does not prohibit coupons but only requires that, if a policy contains them, the premiums charged for the coupon benefits be stated separately from those for the benefits allocable to the policy without coupons. That is hardly the same as saying that coupons have been prohibited. Further, even if the regulation had prohibited them, it would merely show the exercise of state regulation, of which plaintiffs appear to complain, and not that the insurance policy had somehow been converted into a "security".

[6]The references to "App." in the opposition brief are, thus, to the appendix before the court of appeals and not before this Court.

Court at this stage of the proceedings with discussion of such peripheral factual matters (although we would be glad to do so). Nevertheless, two such misconstructions should be mentioned now:

(1) The Great States contract is characterized as including "a fixed, *minimum,* death benefit" (emphasis supplied), thus implying that there are some variable benefits that might be payable above that minimum. This is obviously an instance where it was attempted to force the facts of this case into the mold of *United Benefit,* in which there was a minimum death benefit lumped together with a flexible fund that would, in practical effect as this Court found, determine the actual death benefit. In the Great States policy, there is no minimum death benefit nor is there a maximum. It is simply a fixed amount. In the policy discussed before the Fifth Circuit, the death benefit was $10,000, the endowment benefit was the same should the policyholder live until the maturity date of the policy, the coupons were fixed amounts, and there were fixed cash values. The only feature that was not a fixed dollar amount was the standard participating provision, which is and has been customary in the insurance industry and which has been analyzed by legal authorities, such as Justice Brennan in *VALIC,*[7] not to constitute a "security".

(2) It is stated that the District Court concluded that "sales of these VIP contracts had been ordered stopped by some states." Reference is to the District Court's opinion at App. 189 (A-46), which, in turn, refers to a letter from the Alabama Department of Insurance to Great States in 1963 (after the policies in question here had been sold) requesting a discussion of the type of policies and that they no longer be issued until the matter had been concluded. Plaintiffs' evidence does not show the final disposition of that inquiry; however, in the state court suit by Mr. Henson, one of the named plaintiffs in the instant case, it is shown that the Department (through a Mr. Easterwood) later characterized this same policy as "just a life

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[7]*SEC v. Variable Annuity Life Insurance Co.,* 359 U.S. 65 (1969).

insurance policy participant". *State Security Life Insurance Co. v. Henson,* 288 Ala. 497 at 501, 262 So.2d 745 at 748 (1972). That case only serves to underline some of the reasons life insurance policies, such as the participating policy involved in the present case, are not "securities", viz. that they are and have been subject to state regulation and further that claims on such policies are cognizable in the state courts. As the District Court concluded at A-46, "This fact does not change the exempt status of these insurance policies; rather it confirms the Congressional choice, embodied in the insurance exemption, to leave the regulation of insurance and its sale to the state. Cf. *VALIC,* 359 U.S. at 75 (Brennan, J., concurring)."

Much of the discussion at the end of the opposition brief is directed toward alleged deficiencies in state regulation of insurance. We submit, however, that this is not an issue in this case. If it is an issue at all, it is one before Congress to determine whether state regulation of insurance should be superseded by some federal regulation. To subject insurance policies to federal regulation through 10b-5 litigation not only would create lack of uniformity and uncertainty in results but also would be contrary to the intent of Congress in enacting the Federal Securities Laws (see pg. 9 of the petition) and the admonitions of this Court in *Blue Chip Stamps, United Housing* and *Hochfelder.*[8]

[8]*Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723 (1975), *United Housing Foundation v. Forman,* 421 U.S. 837 (1975), and *Ernst & Ernst v. Hochfelder,* 425 U.S. 185 (1976).

CONCLUSION

For the foregoing reasons and those expressed in their petition for certiorari, petitioners respectfully urge this Court to grant their petition for a writ of certiorari.

Respectfully submitted,

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DEPARTMENTAL REGULATION NO. 47

APRIL 20, 1967

Effective June 1, 1967

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Rule 2. No insurance company, insurance agent, solicitor or insurance company representative shall deliver within this state, or issue for delivery within this state, a policy of life insurance containing benefits in the form of "coupons" or "guaranteed annual endowment" benefts unless the premium charged for the insurance coverage and the premium charged for the "coupons" or "guaranteed annual endowment" benefits are prominently specified in the policy separately from each other in dollar amounts. This Rule 2 shall not apply to any policy in which the amount of any pure endowment or periodic benefit or benefits payable during any policy year is greater than the total annual premium for such years.

In connection therewith, the policy must provide for a distinction between the surrender values available under the insurance coverage as distinct from the "coupon" or "guaranteed annual endowment" benefits. This is to be accomplished by the use of a separate "table of values" in the policy.